Supreme Court, U.S.
FILED
AUG 16 1996
CLERK

(2)

No. 96-82

In The

Supreme Court of the United States

October Term, 1995

OMNITRITION INTERNATIONAL, INC., JAMES FOBAIR, ROGER DALEY AND CHARLES RAGUS,

Petitioners,

vs.

SHAUN WEBSTER AND ROBERT LIGON,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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21 pp

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I. INTRODUCTION

Defendants-Petitioners Omnitrition International, Inc. ("Omnitrition"), James Fobair, Roger Daley, and Charles Ragus seek certiorari from reversal of summary judgment in their favor. In reversing summary judgment for Petitioners, a panel of the United States Court of Appeals for the Ninth Circuit ruled that Plaintiffs-Respondents had presented sufficient evidence to establish genuine issues of material fact on (1) whether the Omnitrition multi-level marketing program is a pyramid sales scheme, and (2) whether investment in the Omnitrition program is an investment in a "security" under the federal securities laws. In applying the definition of "security" in evaluating Petitioners' motion for summary judgment, the Court of Appeals plowed no new ground.[1] In addition, it is clear from the ruling that there was no impermissible shifting of the burden of proof on summary judgment. Petitioners will have an opportunity to argue the disputed factual issues at trial. As the decision of the Court of Appeals raises no ground for the granting of certiorari, the Petition for a Writ of Certiorari should be denied.[2]

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[1] If there is cause for this Court to re-examine the long-standing precedents applying the federal securities laws to pyramid marketing schemes, the appropriate time to do so would be only after the full exposition of the facts after a trial on the merits, and not after merely a "trial by affidavit."

[2] Respondents hereafter cite the Petition for a Writ of Certiorari as "Pet."

II. THE DISTINCTION BETWEEN "VERTICAL COMMONALITY" AND "HORIZONTAL COMMONALITY" AFFORDS NO BASIS FOR THE PETITION.

The test for an investment contract "security" under the federal securities laws is whether "the scheme involves an [1] investment of money in a [2] common enterprise with [3] profits to come solely from the efforts of others." *SEC v. W.J. Howey Co.*, 328 U.S. 293, 301 (1946). In *United Housing Found. v. Forman, Inc.*, 421 U.S. 837 (1975), the Court clarified the requirement that profits accrue *solely* from others' efforts by articulating a practical test that has become the prevailing standard:

> The touchstone [for deciding whether something is a security] is the presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the *entrepreneurial or managerial efforts of others.*

Id. at 852 (emphasis added).

Petitioners argue that the Court of Appeals relied on the concept of "vertical commonality" in finding that Respondents had presented sufficient evidence to withstand summary judgment on the issue of whether the Omnitrition program involves a "common enterprise" as required by *Howey* and its progeny. Petitioners further argue that not only is vertical commonality an improper relaxation of the common-enterprise requirement, but also the use of vertical commonality here highlights the split among the courts of appeals that has arisen from some courts' adoption of vertical commonality and other courts' rejection of vertical commonality in favor of the

stricter concept of "horizontal commonality." Thus, conclude Petitioners, the Court should grant certiorari to resolve this split and reject the use of vertical commonality to satisfy the common-enterprise requirement. (*See* Pet. at 3-22.)

Petitioners' argument suffers from two fundamental flaws. First, neither the District Court nor the Court of Appeals below even addressed the "common enterprise" issue. Second, a pyramid sales scheme satisfies the common-enterprise requirement under either vertical or horizontal commonality, and thus a rejection by this Court of vertical commonality will not change the law on pyramid schemes or the decision of the Court of Appeals in this case.

A. Petitioners Seek This Court's Review Of An Issue That Was Addressed By Neither The District Court Nor The Court Of Appeals.

In granting summary judgment for Petitioners, the District Court ruled that Omnitrition distributorships are not securities for purposes of the Securities Exchange Act of 1934 or section 12 of the Securities Act of 1933. (Appendix to the Petition for a Writ of Certiorari at 49.)[3] The only stated basis for this ruling was the District Court's conclusion that, because Omnitrition distributors engaged in a certain amount of effort in participating in the Omnitrition program, their success did "not depend primarily upon the efforts of others," and distributors

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[3] Respondents hereafter cite the Appendix to the Petition for a Writ of Certiorari as "App."

were not the passive investors the federal securities laws were meant to protect. (*See* App. 46-49.) At no point in its opinion did the District Court analyze the common-enterprise requirement.[4]

Similarly, the Court of Appeals addressed only the requirement that profits come from others' managerial efforts:

> In *Glenn W. Turner* [474 F.2d 476], we determined that the fact that investors in the scheme were required to exert some effort did not automatically preclude a finding that the investments were securities. Instead, we focused on the fact that the scheme's promoters controlled the methods by which the product was sold and new members were recruited. The promoters provided the "essential managerial efforts which affect[ed] the failure or success of the enterprise." *Id.* at 483.
>
> The same is true of Omnitrition's program. Plaintiffs claim that they were taught to sell Omnitrition's "proven plan of success" and to "catch a wave of return that was far beyond anything that [they] were involved in personally." By the very structure of a pyramid

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[4] This is the only mention of the common-enterprise requirement found by Respondents in the District Court's opinion:

> To establish that a transaction involves securities, the Court must determine whether the scheme involves an investment of money in a common enterprise with profits derived solely from the efforts of others.

(App. at 47 (citing *Howey*, 328 U.S. at 301).)

> scheme, participants' efforts are focused not on selling products but on recruiting others to join the scheme. Under the reasoning of *Glenn W. Turner*, this is enough to bring investments in the program within the definition of "investment contracts."

(App. at 14-15 (interpolations in opinion of Court of Appeals).)

As with the District Court's opinion, at no point in *its* opinion did the Court of Appeals analyze the common-enterprise requirement, much less apply the concept of vertical commonality in doing so.[5]

Thus, Petitioners want this Court to grant certiorari to address an issue which was addressed by neither the District Court nor the Court of Appeals below. Respondents submit that this is not one of the "compelling reasons" for which the Court grants certiorari, *see* Rule 10 of the Rules of the Supreme Court of the United States. Certiorari should be denied.

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[5] This is the only mention of the common-enterprise requirement found by Respondents in the opinion of the Court of Appeals:

> An investment contract is a transaction in which "the scheme involves an investment of money in a common enterprise with profits to come solely from the efforts of others."

(App. at 14 (citing *Howey*, 328 U.S. at 301).)

B. A Pyramid Sales Scheme Satisfies The Common-Enterprise Requirement Under Either Vertical Or Horizontal Commonality.

Even if the common-enterprise requirement were an issue appropriately raised in Petitioners' request for a writ of certiorari – and it is not – a pyramid sales scheme satisfies the requirement under either vertical or horizontal commonality. Thus, because what Petitioners ultimately seek – a rejection by this Court of vertical commonality – would not change the decision of the Court of Appeals, certiorari should be denied. In *SEC v. Glenn W. Turner Enters., Inc.*, 474 F.2d 476 (9th Cir.), *cert. denied*, 414 U.S. 821 (1973), in which a panel of the Ninth Circuit affirmed the district court's granting of a preliminary injunction against a pyramid sales scheme, the court of appeals adopted an interpretation of the common-enterprise requirement that became known as "vertical commonality," stating, "A common enterprise is one in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment [*i.e.*, the promoters or sellers] or of third parties." *Id.* at 482 n.7. The court of appeals stated without discussion that the scheme in question fulfilled the common-enterprise requirement of the *Howey* test; analyzed the requirement of profits coming from the efforts of others; and ruled that the scheme involved a security under the federal securities laws. *See id.* at 481-83.

The Sixth Circuit, as Petitioners correctly note, (*see* App. at 4, 7 & n.4, 13), has rejected vertical commonality and requires horizontal commonality. *See Curran v. Merrill, Lynch, Pierce, Fenner & Smith, Inc.*, 622 F.2d 216, 222

(6th Cir. 1980) ("[W]e . . . reject the vertical commonality approach. . . . "), *aff'd*, 456 U.S. 353 (1982) (affirming on issue of whether private right of action exists under Commodity Exchange Act). Nevertheless, in *Davis v. Avco Fin. Servs., Inc.*, 739 F.2d 1057 (6th Cir. 1984), *cert. denied*, 470 U.S. 1005 (1985), another panel of the Sixth Circuit ruled that a pyramid sales scheme involved a "security." In *Davis*, participants in the scheme sued a finance company, from whom plaintiffs borrowed money to invest in the scheme, and the finance company's manager, who had promoted the scheme to plaintiffs and solicited their loans. Plaintiffs asserted claims under the Securities Act of 1933 and the Securities Exchange Act of 1934. After a bench trial, the district court ruled that the promissory notes given by plaintiffs for their loans, as well as plaintiffs' investments in the pyramid scheme, were "securities" under the relevant statutes, and entered judgment in favor of plaintiffs on their Securities Act claims. *See* 739 F.2d at 1059-62. The court of appeals affirmed in part and reversed in part the judgment and remanded the case for further proceedings. While the court of appeals disagreed with the district court's ruling that the promissory notes given by plaintiffs were securities, the court of appeals agreed as to the pyramid scheme investments:

> We do agree, however, that the DTBG adventures were securities. In this regard we concur with and adopt the analysis in *S.E.C. v. Glenn W. Turner Enterprises, Inc.*, 474 F.2d 476 (9th Cir.), . . . and *S.E.C. v. Koscot Interplanetary, Inc.*, 497 F.2d 473 (5th Cir. 1974). We will not reiterate this analysis in the hope of keeping this opinion to a reasonable length.

739 F.2d at 1063.

Indeed, Respondents have found no decision in which a court has ruled that a pyramid scheme is *not* a "common enterprise" for purposes of determining whether a security is involved. In *SEC v. International Loan Network, Inc.*, 968 F.2d 1304 (D.C. Cir. 1992), for example, the court of appeals affirmed the district court's holding that a pyramid scheme violated the federal securities laws and its granting of a preliminary injunction against the scheme:

> As for the common enterprise element, the fortunes of investors are clearly linked to each other and to the success of ILN as an enterprise. The CFBS generates income for its investors, and for the [defendants] . . . , only through constant expansion of membership, which depends on individual recruiting and the appeal of [the promoter] Ford's larger marketing campaign. Thus, the court properly found the CFBS satisfies the second prong of the *Howey* test as well.

Id. at 1308.[6]

In the opinion affirmed by the court of appeals, *SEC v. International Loan Network, Inc.*, 770 F. Supp. 678 (D.D.C.

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[6] The District of Columbia Circuit has not adopted either vertical commonality or horizontal commonality over the other. *See SEC v. Life Partners, Inc.*, 87 F.3d 536, 544 (D.C. Cir. 1996) (ruling that investment program involved common enterprise under concept of horizontal commonality although ruling that profits were *not* derived predominantly from others' efforts) ("We need not reach, therefore, the SEC's alternate contention that the LPI program entails 'strict vertical commonality' – another formulation of the common enterprise test recognized in some circuits.")

1991), the district court noted that the pyramid scheme in question was a common enterprise under either vertical or horizontal commonality:

> The second element of the *Howey* test requires the investment to be in a "common enterprise." This test is met whether the Court looks to *Glenn W. Turner, Koscot,* or the opinion of my colleague on this court in *Meredith v. Conticommodity Services, Inc.*, 1980 Fed. Sec. L. Rep. (CCH) ¶ 97,701 (D.D.C. 1980) (Gasch, J.). In *Meredith,* the court intimated that commonality requires a correlation between the profits and losses of individual investors and the fortunes of the investors as a group or with the enterprise itself. The profits of investors in the Capital Funds Bonus System are directly related to the fortunes of other investors: it is through the constant recruitment of new members in one's "downline" that income is earned. If the people directly recruited by an Independent Representative do not vigilantly spread the word "you come in, then you bring in your wife and your kids," then that Independent Representative will not earn much income through the program. Additionally, investors' profits are linked to the success or failure of ILN as a whole because it is the ability to proclaim the organization's success that is the central selling point of the program. The testimonials presented in the videotape "Common Ground" illustrate the crucial role that the organization plays in recruitment.

770 F. Supp. at 691-92 (citation omitted).

The observations of the court of appeals and the district court in *International Loan* apply equally here. As

stated above, the common-enterprise issue was not even discussed by the Court of Appeals below, and thus Respondents cannot cite any such discussion now. Nevertheless, to rebut Petitioners' argument, Respondents elaborate on their theory, which they briefed below, on how the Omnitrition program is a common enterprise. The fortunes of all Omnitrition distributors are linked to the success of the company and its promoters in continuing to attract new recruits and keep the scheme going. The "real money" promised to Omnitrition distributors by the Omnitrition marketing plan is to be made by recruiting others. It is the marketing plan devised by Omnitrition and its promoters which is the fundamental lure for new recruits. It is the managerial and entrepreneurial efforts by Omnitrition and its promoters to pitch that plan, whether through recruitment meetings, revival-like recruitment rallies, or other devices such as promotional videotapes and other materials disseminated for showing to prospective distributors, which are the most important means of recruiting new distributors. Omnitrition receives a great deal of money from the purchase of products by its distributors. From those funds, the company pays for, among other things, the recruitment rallies, the costs of producing promotional materials, and the compensation of its pitchpersons – all for the purpose of recruiting still more distributors. Without such efforts by Omnitrition and its promoters, the flow of new recruits will dry up, endangering the fortunes of all Omnitrition distributors. Conversely, if Omnitrition's recruiting efforts are successful, and the company thrives, the fortunes of all Omnitrition distributors are improved by their enhanced ability to obtain new downline recruits

to generate income for them. Omnitrition and its promoters spend funds obtained from distributors on efforts to recruit more and more people, to the benefit of all distributors. Thus, the Omnitrition scheme passes either the vertical-commonality or the horizontal-commonality test. *See International Loan*, 968 F.2d at 1308 ("As for the common enterprise element, the fortunes of investors are clearly linked to each other and to the success of ILN as an enterprise.").

Therefore, even if the common-enterprise issue were properly raised by Petitioners now, and the Court granted certiorari and (as Petitioners want the Court to do) rejected vertical commonality, the decision of the Court of Appeals would be unaffected. Thus, assuming that the Court wishes to address the issue of vertical commonality versus horizontal commonality, this case is an inappropriate vehicle to do so.[7]

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[7] Petitioners misdirect the discussion by arguing that cases applying the definition of security to *real estate developments* and *brokerage accounts* show that there would be a split among the courts of appeal on whether a *pyramid scheme* involves a security. (*See* Pet. at 8-15.) That conclusion does not logically follow. Similarly, Petitioners cite *Reves v. Ernst & Young*, 494 U.S. 56 (1990), for its four-part test for whether an instrument denominated a "note" is a security. (*See* Pet. at 22-23.) Omnitrition distributorships are neither notes nor denominated as such, and the appropriate test to apply is that applied by the Court of Appeals below: the test created in *Howey* for deciding whether an "investment contract" is a security. *See Reves*, 494 U.S. at 64 (setting forth *Howey* test and rejecting its application to notes).

III. THE COURT OF APPEALS PROPERLY IMPOSED THE EVIDENTIARY BURDENS IN EVALUATING DEFENDANTS' MOTION FOR SUMMARY JUDGMENT.

Petitioners also claim that the Court of Appeals erroneously allocated the burdens of proof in evaluating Petitioners' summary judgment motion, and, as a result, proceeded on the presumption that Omnitrition is a pyramid sales scheme and required Petitioners to produce evidence that it is not. (*See* App. at 5, 23-30.) Petitioners assert that, to discharge their initial burden on summary judgment, all they had to do was to " 'point[ ] out . . . that there is an absence of evidence to support the nonmoving party's case.'" (App. at 23 (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 325 (1986)).) Petitioners also assert that the burden on Respondents "was to produce evidence of material facts in dispute on each element of their claims." (App. at 24.) Contrary to Petitioners' argument, the Court of Appeals did nothing inconsistent with these principles.

On the issue of whether Omnitrition is a pyramid sales scheme, Respondents discharged their burden. As the Court of Appeals observed, pyramid schemes

> "are characterized by the payment by participants of money to the company in return for which they receive (1) the right to sell a product *and* (2) the right to receive in return for recruiting other participants into the program rewards which are unrelated to sale of the product to ultimate users."

(App. at 7 (quoting *In re Koscot Interplanetary, Inc.*, 86 F.T.C. 1106, 1181 (1975), *aff'd sub nom. Turner v. FTC*, 580 F.2d 701 (D.C. Cir. 1978)) (emphasis in *Koscot* opinion).)

Petitioners agree with this two-prong test but argue that Respondents did not produce evidence that Omnitrition meets it. (*See* Pet. at 24, 26 & n.12.) On the contrary, in both the District Court and the Court of Appeals, Respondents presented evidence on the operation of the Omnitrition program and explained how the program's very structure fit the above definition. The Court of Appeals agreed with Respondents:

> To become a supervisor, a participant must pay a substantial amount of money to Omnitrition in the form of large monthly product orders . . . . In exchange for these purchases, the supervisor receives the right to sell the products and earn compensation based on product orders made by the supervisor's recruits. *This compensation is facially unrelated to the sale of the product to ultimate users* because it is paid based on the suggested retail price of the amount *ordered* from Omnitrition, rather than based on *actual sales* to consumers.
>
> On its face, Omnitrition appears to be a pyramid scheme.

(App. at 8-9 (first emphasis added).)

Thus, the Court of Appeals concluded:

> Omnitrition argues that [Respondent] Webster failed to submit sufficient admissible proof that Omnitrition is a pyramid scheme. We disagree. The *mere structure of the scheme* suggests that Omnitrition's focus was in promoting *the program* rather than selling *the products*. When added to statements from Webster's and [Respondent] Ligon's depositions, plaintiffs

> have produced sufficient evidence to defeat summary judgment.

(App. at 10 (first emphasis added).)

Given that Respondents had met their burden on summary judgment, Petitioners' evidence was insufficient to show the absence of a factual dispute on whether Omnitrition is a pyramid scheme:

> To rebut the pyramid allegations, Omnitrition relies heavily on *In re Amway Corp.*. 93 FTC 618 (1979), in which the FTC found Amway was not a pyramid scheme because its policies prevented inventory loading and encouraged retail sales. *Id.* at 715-16. Omnitrition argues that its formal adoption of policies similar to Amway's was sufficient to support summary judgment. We disagree.
>
> . . . .
>
> Omnitrition has distribution rules modeled on Amway's. However, the existence and enforcement of rules like Amway's is only the first step in the pyramid scheme inquiry. Where, as here, a distribution program appears to meet the *Koscot* definition of a pyramid scheme [as shown by Respondents' evidence], there must be evidence that the program's safeguards are enforced and actually serve to deter inventory loading and encourage retail sales. In *Amway*, the ALJ made that crucial finding of fact, after a full trial. *See id.* at 631. Our review of the record does not reveal sufficient evidence to establish as a matter of law that Omnitrition's rules *actually work*.

> Further, Omnitrition's rules, while carefully crafted to appear like those in *Amway*, are weaker in operation.

(App. at 10-11.) Of the three "anti-pyramiding" policies formally adopted by Omnitrition, for only one did Petitioners produce evidence of enforcement, and the Court of Appeals found that even that evidence was insufficient to establish that the rule in fact effectively discouraged pyramid-scheme activity. (*See* App. at 11-12.)

The Court of Appeals did not proceed to evaluate Petitioners' summary judgment motion from the presumption that Omnitrition is a pyramid scheme. Respondents produced evidence that Omnitrition is a pyramid scheme. Petitioners produced some evidence purportedly showing that Omnitrition is not. The Court of Appeals ruled that, based on the evidence, there was a genuine issue of material fact on whether Omnitrition is a pyramid scheme. On this basis, the Court of Appeals properly reversed summary judgment. *See Celotex*, 477 U.S. at 325 ("Rule 56 mandates the entry of summary judgment . . . against a party who *fails* to make a showing sufficient to establish the existence of an element essential to that party's case, and on which the party will bear the burden of proof at trial.") (emphasis added). While Petitioners may quarrel with the weight the Court of Appeals placed on the parties' evidence, this matter is inappropriate for review by this Court. *See* Rule 10 of the Rules of the Supreme Court of the United States ("A petition for a writ of certiorari is rarely granted when the asserted error consists of erroneous factual findings or the misapplication of a properly stated rule of law.").

IV. NEITHER PETITIONERS' IMPROPER REARGUMENT OF THEIR SUMMARY JUDGMENT MOTION NOR THEIR POLICY-BASED ARGUMENT SUPPORTS THE GRANTING OF CERTIORARI.

Petitioners improperly reargue the merits of their summary judgment motion before this Court. Petitioners contend, "[T]he Ninth Circuit Court dismissed the fact that Omnitrition's participants' profits result entirely from their own labors. . . . " (Pet. at 5.) Petitioners assert that "an IMA's [*i.e.*, distributor's] earnings do not result from any effort by Omnitrition to recruit IMAs." (Pet. at 6-7 n.3.) In both the District Court and the Court of Appeals below, Petitioners had argued that the efforts by Omnitriton distributors precluded the conclusion that Omnitriton involved a security. The Court of Appeals rejected the argument, ruling that the evidence created a genuine issue as to whether distributors' profits resulted only from their own efforts or whether the profits depended on the "essential managerial efforts" of Omnitrition and its promoters. (*See* App. at 14-15 (quoting *Glenn W. Turner*, 474 F.2d at 482).) Certiorari should not be granted simply to allow Petitioners to reargue their summary judgment motion.

In addition, Petitioners urge the Court to grant certiorari on the ground that "this case is vitally important to multi-level companies and their distributors in the United States, a multi-billion dollar industry. . . . " (Pet. at 5.)[8] Petitioners argue:

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[8] In support of their assertion, Petitioners cite and attach to their petition an amicus curiae brief which the Direct Selling

> The error [of the Court of Appeals] imposes upon a multi-level company, a defendant-movant for summary judgment in this case, the burden to produce evidence that it is not an illegal pyramid scheme. . . . [T]he court has, perhaps unwittingly, established a presumption of illegality against all multi-level companies, which could force a company to trial merely by brandishing the company's brochure.

(Pet. at 29.) As explained above, there was no error (even leaving aside that the company's own brochures and promotional materials may indeed be highly reliable and probative evidence for the trier of fact). The Court of Appeals did not rule that Omnitrition *is* a pyramid scheme. The Court of Appeals ruled that the parties' evidence established a genuine factual dispute as to the matter. There is no "presumption of illegality against all multi-level companies." To defeat summary judgment on a claim that a multi-level marketing company is a pyramid scheme, any plaintiff will have to produce evidence that the program meets the definition of a pyramid scheme, as Respondents did here.

Nothing in the opinion of the Court of Appeals calls for the granting of certiorari. The purported importance of this case to multi-level marketing companies does not by itself support Petitioners' request for certiorari.

Association attempted to file in the Court of Appeals to support Petitioners' petition for rehearing. (*See* Pet. at 5 n.2; App. at 86-117.) It is inappropriate for Petitioners to rely on the brief, as the Court of Appeals denied the Direct Selling Association leave to file it. (*See* App. at 84.)

V. CONCLUSION

For the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Dated: August 16, 1996

Respectfully submitted,

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